COMMONWEALTH OF MASSACHUSETTS
before the
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Colonial Gas Company	)	**D.T.E. 00-73**
d/b/a KeySpan Energy Delivery	)	

INITIAL BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,

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I. INTRODUCTION

On September 15, 2000, Colonial Gas Company ("Colonial" or "Company") filed a petition with the Department of Telecommunications and Energy ("Department") proposing the recovery of lost revenues associated with its demand-side management ("DSM") programs for the period May 1999 through April 2000. On October 23, 2000, the Department issued an Order of Notice and scheduled a public hearing and a procedural conference for November 16, 2000. The Department indicated that it would also review the Company's request to recover certain lost revenues as an exogenous cost adjustment to the rate freeze approved in *Eastern/Colonial Acquisition*, D.T.E. 98-128 (1999).

The Attorney General urges the Department to deny the Company's recovery of both the Lost Base Revenues ("LBR") it claims as an exogenous cost under the Company's merger rate plan, as well as those LBRs claimed under the Company's current DSM program. Furthermore,

the Attorney General urges the Department to reduce the Company's rates to reflect the exogenous costs caused by the bad debt accounting change which resulted from the Department-ordered unbundling of rates.

II. PROCEDURAL HISTORY

On September 15, 2000, Colonial filed a petition with the Department seeking recovery of a total of $1,267,772 of Lost Base Revenues ("LBR"s). The Company proposes to collect $550,587 of LBRs associated with its current DSM programs and $717,135 of LBRs it maintains are recoverable as exogenous costs under the merger rate plan approved in D.T.E. 98-128 through its Local Distribution Adjustment Clause ("LDAC").[1]

Although the Company provided no prefiled testimony with or subsequent to its filing, the Department did allow discovery. The Department held a technical session on January 19, 2001 to allow the Company to "give an overview of what an LBR filing is . . . , for educational purposes,. . . ." Tr. 1/19/01, p. 3. At this technical session the Company presented Ann Leary, manager of rates and Jen Bedard, business marketing planner, who made unsworn statements concerning the history of Demand Side Management ("DSM") and recovery of LBRs.

An evidentiary hearing was held on February 8, 2001. At that hearing, the Company presented Ann Leary and Jen Bedard. Rather than presenting direct sworn testimony, Colonial moved into evidence the transcript of the January 19, 2001 technical session. The Hearing

[1] Colonial is a wholly-owned subsidiary of KeySpan Energy Delivery that provides natural gas distribution services to over 155,000 customers in the towns of Billerica, Chelmsford, Dracut, Dunstable, Lowell, North Reading, Pepperell, Tewksbury, Tyngsboro, Westford, and Willmington (the Lowell Division), and Barnstable, Bourne, Brewster, Chatham, Dennis, Eastham, Falmouth, Harwich, Mashpee, Orleans, Sandwich, Wareham, and Yarmouth (the Cape Cod Division).

Officer allowed the introduction of the transcript over the objection of the Attorney General. (Tr. 2/08/01, pp. 8-13). [2]

III. STATEMENT OF THE CASE

Beginning in 1988, the Department has considered various methodologies to provide appropriate ratemaking recognition of revenue reductions resulting from mandated conservation and DSM measures. *See Integrated Resource Management*, D.P.U. 86-36-F(1988); *Eastern Edison Company*, D.P.U. 94-4-CC (1994). In *Colonial Gas Company*, D.T.E. 97-112 (1999), the Company failed to persuade the Department that the Department's methodology of computing LBRs for electric companies, the Rolling Average Period Method, was inappropriate for gas companies. Colonial's contention that an additional three years of collections was necessary for gas companies was rejected.

The Company now seeks to charge customers $717,135 for LBRs as an "exogenous cost" under the rate plan approved by the Department in *Eastern Enterprises-Colonial Gas Company*,

[2] The Attorney General set forth his objection in a letter to the Company dated February 8, 2001, a copy of which was provided to the Hearing Officer. Colonial represented to both the Department as well as to the Attorney General that the prepared materials at the technical conference were for "educational purposes" only (Tr. 1/19/01, pp. 3, 38) for the benefit of new employees at the Department. The Attorney General had no prior notice that the "educational" presentation would be recorded and, thus, was deprived of an opportunity to prepare effectively a contemporaneous cross-examination. The use of the "educational" material as a substitute for prefiled testimony deprived the Attorney General of an opportunity to conduct discovery on this "testimony," since he had only two days notice of the Company's proposal to introduce the transcript of the technical session as evidence during the evidentiary hearings. *See* 220 C.M.R. 1.10(4) & (5) (seven days advance notice required before offering prepared testimony or exhibits). Moreover, the Company employees were not sworn as witnesses and their statements cannot constitute evidence. 220 C.M.R. 1.10(1). The "high-level overview" narrative (Tr. 1/19/01, p. 4) and "hypothetical example" (Tr. 1/19/01, p.8) offered by the employees does not rise to the level of evidence. Finally, according to longstanding Department practice, technical sessions are informal in nature and the statements made during the technical sessions are not to be referenced as evidence.

D.T.E. 98-128 (1999) ("merger order") and $550,587 for LBRs in the Demand-Side Management ("DSM") component of its LDAC. The Company has determined two LBR amounts (1) for the program years 1992-1995 and (2) for the four-year rolling average beginning in 1996 and ending in April 2000.[3] For the period October 1992 through April 1996, the Company has calculated LBRs of $717,135, the amount it seeks as an exogenous cost. *See* Response to AG1-2. For the period May 1996 through April 2000, the Company has calculated LBRs of $550,587, the amount it seeks to recover under the Department's current DSM program. *Id.* In total, the Company seeks $1,267,722 in LBRs by its present request.

The Attorney General has appealed the Department's decision in *Eastern Enterprises-Colonial Gas Company*, D.T.E. 98-128 (1999), specifically the portion of the decision approving the Companies' proposed "rate plan." *Attorney General v. Department of Telecommunications and Energy*, SJC-1999-0384. Although Attorney General does not concede in this proceeding that the rate plan was properly approved, for purposes of this proceeding, the Attorney General frames his arguments within the confines of that rate plan. The Attorney General does not, however, waive or relinquish any argument which may be made in his appeal of D.T.E. 98-128.

IV. STANDARD OF REVIEW

Review of the Company's proposal requires the application of two standards of review - one for the $717,135 of "exogenous cost" LBRs the Company would like to recover under the

[3] *See* Response to AG-1-2. This Response also references a communication of August 28, 2000, from the Company to the Department, wherein the Company states that it will not seek LBR recovery after April 2000. The Department is requested to admit the entire Response to AG-1-2 into the record, including the August 28, 2000 letter.

merger rate plan, and one for the $550,587 of "DSM" LBRs.

The Department's standard for the determination of an exogenous cost is found in both the merger and acquisition related dockets and the price cap related dockets. "The Department has defined exogenous costs as positive or negative cost changes beyond a company's control that would significantly affect the company's operations." *Eastern Enterprises/Colonial Gas Company*, D.T.E. 98-128, p. 54 (1999). In Colonial's acquisition by Eastern Enterprise, the Company proposed to freeze its base rates for gas distribution service for ten years with the condition that it could adjust rates for certain exogenous costs. *Eastern Enterprises/Colonial Gas Company*, D.T.E. 98-128, p. 8; *see also,* D.T.E. 98-128 Exh. NS-1, p. 7 and Exh. JFB-1, p. 7. The Department approved the Company's proposed ten-year rate freeze and explained that it would consider recognition of exogenous cost adjustments to the extent that they complied with those requirements as set forth in previous merger dockets. *NIPSCO/Bay State Gas Company*, D.T.E. 98-31, p. 17 (1998) citing D.P.U. 96-50; *Eastern Enterprises/Essex County Gas Company*, D.T.E. 98-27, p. 19 (1998) citing D.P.U. 96-50 (Phase I), p. 292. The definition of exogenous costs in both those cases comes from the base rate case and price cap formula in *Boston Gas Company*, D.P.U. 96-50, pp. 284-293 (1996). There the Department found that the exogenous costs could be recovered under the following conditions:

- changes in tax laws that uniquely affect the local gas distribution industry;
- accounting changes unique to the local gas distribution industry; and
- regulatory, judicial or legislative changes uniquely affecting the local gas distribution industry.

Id. p. 292. *See also NIPSCO/Bay State Gas Company*, D.T.E. 98-31 (1998); *Eastern*

Enterprises/Essex County Gas Company, D.T.E. 98-27, *supra*. Proponents of exogenous cost adjustment bear the burden of demonstrating that the costs were (1) beyond the company's control, and (2) not reflected in Gross Domestic Product - Price Index ("GDP-PI"). The Department also found that exogenous costs would have to reach a threshold of approximately 1.8 % of earnings before the Company could collect such exogenous costs. Tr.1, pp. 48-49.

With respect to the recovery of LBRs associated with DSM, the Department has applied the Rolling Period Method to the Company. *Colonial Gas Company*, D.T.E. 97-112 (1999). The Rolling Period Method allows for the recovery of "LBR associated with a specific year of DSM implementation to be recovered for a period equal to the average length of time between each of a company's last four rate cases, or until new rates take effect subsequent to a new base rate proceeding." *Id*., p. 11. "Once a utility completes a rate case, that utility's LBR is reduced to zero." *Id*., p. 10 n.8. The Department found that the Rolling Period Method will provide companies with a direct and consistent incentive to reduce costs and improve the efficiency of its operations.

V. ARGUMENT

There are two issues before the Department in this case. First, the Department must determine whether the LBRs through the year 2000 were incorporated into the determination of the Company's most recently approved rates as a result of the price freeze approved in the Company's merger order. Second, the Department must decide whether to reduce the Company's rates to recognize savings resulting from a change in the accounting for bad debt expense which was caused by the Department ordered unbundling of the Company's rates.

A. THE DEPARTMENT INCORPORATED ALL LBRS IN THE DETERMINATION OF THE APPROPRIATENESS OF COLONIAL'S BASE RATES AND THE BASE RATE FREEZE IN THE COMPANY'S MERGER CASE

In D.T.E. 98-128, the Department approved a 10-year rate freeze, and in doing so, determined that rate revenues, excluding LBRs, were adequate for the Company to carry on its operations during this period. The Company cannot now defy the rate freeze by seeking recovery of LBRs which explicitly incorporated in its revenue determination in that case.

Within the merger rate plan is the so-called "cast-off revenue requirement" that, according to the Department's order, will be used to fashion future rates once the rate freeze is over.[4] In order to establish the cast-off revenue requirement of $91 million, the Company used a test year of 1997 and rolled up certain costs such as wages to the year 2000. *See* D.T.E.98-128, p. 20; Compliance Filing, Sch. A. An integral part of the Department's review of the Company's rate plan was not only the revenue requirement but also the level of revenues that the Company would be generating by the frozen rates. The Company specifically made *pro forma* revenue adjustments to its 1997 test year cost of service removing its total LBRs from its test year revenue. This adjustment decreased test-year revenues by more than $900,000 per year. *See* D.T.E. 98-128 Exh. DTE-4-3 (Rev.); Compliance Filing, Sch. A. With this adjustment, the Company claimed and the Department found its rates to be adequate. The Company cannot now

[4] "...the Department evaluates the reasonableness of each component of the cast-off revenue requirement for the purpose of determining the starting point for the model of Colonial's revenue requirement, absent the merger [sic] for the limited purpose of determining (1) the savings associated with the avoidance of a rate case over ten years; and (2) what Colonial's revenue requirement would be at the end of year ten of the rate freeze had Colonial operated on a stand-alone basis." D.T.E. 98-128, p. 21.

defy that rate freeze by seeking to recover LBRs.[5] Therefore, the Department should deny the Company's request to recover all of its LBRs.

B. THE DEPARTMENT SHOULD ORDER THE COMPANY TO REDUCE RATES TO RECOGNIZE THE REDUCTION IN BAD DEBT COSTS AS A RESULT OF ITS ORDER UNBUNDLING RATES

The Company has failed to propose the reduction to bad debt costs that resulted from the Department-ordered unbundling of rates as an exogenous change. After the Department approved the rates and the rate freeze in the Company's merger case, the Department ordered the Company to unbundle its rates into its component parts so that the distribution rate would include only local transportation costs and the cost of gas adjustment clause ("CGAC") would include all gas related costs. *Colonial Gas Company*, D.T.E. 98-64 (1998). The unbundling of rates required the Company to shift its recovery of gas related bad debt expenses (also known as uncollectible expense) from base rates to its CGAC. This ordered change in rates and the resulting accounting change caused the Company to profit from a $1.1 million reduction in cost.

Colonial's $1.1 million windfall from the change in bad debt is an exogenous cost as contemplated by the Department. The Department's definition of exogenous costs includes: "regulatory, judicial or legislative changes uniquely affecting the local gas distribution industry." D.P.U. 96-50, p. 292. The Department also found that the change must be beyond the Company's control, not reflected in GDPPI, and beyond a threshold of 1.89% of the Company's earning, or in the case of Colonial $250,000. *Eastern Enterprises/Colonial Gas Company*, D.T.E. 98-128, p. 55. This change in bad debt costs meets all of the Department's requirements

[5] The Company's proposal would allow it to double collect LBRs.

for exogenous costs. As the Company reported to investors, the bad debt reduction was as the result of a Department (regulatory) ordered change for the gas industry in Massachusetts. Exh. AG-1-2, Security and Exchange Commission 1999 10-K, p. 7. That regulatory change caused costs to be affected by an amount exceeding the $250,000 threshold. Finally, since the unbundling of gas rates is unique to the gas industry, it would not be reflected in the GDP-PI. Therefore, the Department should allow customers to benefit from this cost reduction.

VI. CONCLUSION

The Attorney General requests that the Department reject Colonial's request to recover all LBRs since those costs were incorporated into the Company's base rate determination. Furthermore, the Attorney General requests that the Department order the Company to reduce rates to reflect the exogenous cost adjustment regarding a change in the accounting for bad debt expense as a result of the unbundling of the Company's rates.

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